

ALASKA STATE LEGISLATURE

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SENATOR PETER A. MICCICHE

Sponsor Statement

CS SB 83 (FIN)-INTEREST ON CORPORATION INCOME TAX

DISTRICTS

Anchor Point

Clam Gulch

Cohoe

Diamond Ridge

Fox River

Fritz Creek

Funny River

Halibut Cove

Happy Valley

Homer

Kachemak City

Kachemak Selo

Kalifornsky

Kasilof

Kenai

Nikolaevsk

Nimilechik

Razdolna

Ridgeway

Seldovia

Soldotna

Voznesenka

Under AS 43.05.225, the State of Alaska is required to charge contractors undertaking long-term projects an interest rate on all delinquent taxes of 5 points above the current annual rate charged by banks for advances or 11%, whichever is greater. Due to low interest rates, the rate in effect has been 11% for a number of years.

This delinquent tax penalty has created a negative impact to the construction industry, due to the way contractors are required to account for long-term contracts by the IRS and Generally Accepted Accounting Principles (GAAP).

Many of our larger construction projects in Alaska are multi-year projects. They are accounted for as long-term contracts and are required to use a percentage of completion reporting method. Specifically, contractors calculate the estimated profit of a project that is completed within a single tax year and pay the tax on the estimated profit, as detailed in Title 26, Section 460 of the IRS Code.

Although contractors do their best to estimate project costs and potential profits at the beginning of a project, as the project progresses and the risks are reduced, estimated profits can rise. At the end of a project when the actual profit is known, contractors are required to file look-back taxes and either pay on the increased profit or receive a refund on any overpayment. It is common practice within the construction business is to estimate conservatively and thus have additional taxes to pay when "looking back." These payments under long-term contracts should be considered amended tax returns not delinquent payments subject to such severe penalty.

Under the same IRS code which requires long-term contracts to be based upon a percentage of completion method, interest rates are established for both overpayments and underpayments. Overpayments and underpayments are assessed an interest rate of the Federal short-term rate plus 2 percent if under \$10,000, and plus .5 percent if over \$10,000.

For the purposes of paying state corporate income taxes, this bill applies the interest rates established under 26 U.S.C. 460 on all long-term contracts covered by 26 U.S.C. 460 beginning with the 2013 tax year. This is accomplished by adding a new subsection to AS 43.20.021, the Department of Revenue's statutes governing the adoption of IRS code by reference.